

**Frankfort - Elberta Area Schools**

**FINANCIAL STATEMENTS  
AND REPORT OF INDEPENDENT  
CERTIFIED PUBLIC ACCOUNTANTS**

June 30, 2006

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## **Management's Discussion and Analysis For the year ended June 30, 2006**

Our discussion and analysis of Frankfort-Elberta Area Schools' (the "District") financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2006. Please read this analysis in conjunction with the District's financial statements, which immediately follow this section.

### **Description of Reporting Entity and Services Provided**

Frankfort-Elberta Area Schools, located in Frankfort, Michigan in Benzie County, is nestled on the shores of Lake Michigan, 45 miles west of Traverse City. The school population for the 2005-2006 school year is approximately 600 students who are eager to learn. Twelve percent of the students in the district are "Schools of Choice" coming from Benzie Central, Onkama and Glen Lake. Because of small class sizes, students are given more individual attention in the classroom. Educators are dedicated and caring and always look out for the student's best interest. MEAP and standardized test scores are consistently above average. The community has been extremely supportive over the years and parents are very involved in the schools in a positive way whether it is fund raising, volunteering in the classrooms, or attending the many events at the school. Frankfort boasts outstanding athletic, drama and music programs that allow students to learn outside of the classroom.

### **Overview of the Financial Statements**

This annual report consists of three sections presented in the following order: Management's discussion and analysis, the basic financial statements, and required supplementary information. The basic financial statements include two kinds of statements that present different views of the District:

- The first two statements are *district-wide financial statements* that provide comprehensive *short-term* and *long-term* financial information about the District as a whole.
- The remaining statements are *fund financial statements* that focus on *individual parts* of the District, reporting the District's operations *in more detail* than the district-wide statements.
- The *governmental funds* statements tell how *basic* services like regular and special education were financed in the *short-term* as well as what remains for future spending.
- *Fiduciary funds* statements provide information about assets held by the District in a *trustee* or *agent* capacity.

The financial statements also include notes that explain some of the information in the statements and provide more detailed data and supporting documentation. The statements are followed by a section of required supplementary information that further explains and supports the financial statements with a comparison of the District's budget for the year. Figure A-1 shows how the various parts of this annual report are arranged.

**Figure A-1**

**District Financial Report Organization**

**Management's Discussion and Analysis (MD&A)**  
(Required Supplemental Information)

**Basic Financial Statements**

District-wide Financial Statements/Fund Financial Statements

**Notes to Basic Financial Statements**

Budgetary Information for Funds  
(Required Supplemental Information)

Other Supplemental Information

**District-Wide Statements**

The district-wide statements provide comprehensive information about the entire District using the accrual basis of accounting which is similar to the method used by private-sector companies. The statement of net assets includes all of the District's assets and liabilities and the difference between the two, which is net assets. The statement of activities accounts for all of the current year's revenues and expenses regardless of when cash is received or paid.

The statement of net assets and statement of activities report the governmental activities for the School District, which encompass all of the School District's services, including instruction and supporting services. Unrestricted State Aid and property taxes finance most of these activities.

The two district-wide statements report the District's *net assets* and how they have changed. Examining net assets is one way to measure the District's financial health or *position*. Over time, increases or decreases in the District's net assets are an indicator of whether its financial position is improving or declining. The relationship between revenues and expenses is the District's operating results, or in other terms, whether the District had a profit or a loss at year end. However, the District's mission is not simply to generate profits, as may be the case for a commercial entity.

## **Fund Financial Statements**

The fund financial statements provide more detailed information about the District's funds. Each major fund is presented in a separate column. Non-major funds are aggregated and displayed in a single column. Funds are accounting devices the District uses to keep track of specific sources of funding and spending on particular programs. Some funds are required by State law and by bond covenants. The District has two kinds of funds:

### **Governmental Funds:**

All of the District's basic services are included in governmental funds. Governmental fund reporting generally focuses on how dollars flow in and out of the funds and the balances left at year-end. These balances are reported using the modified accrual basis of accounting. Revenues are recognized when they are measurable and available. Expenditures are recorded when the related fund liability is incurred. The governmental fund statements provide a detailed short-term view of the operations of the District and the services it provides. Governmental fund information helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. The relationship or differences between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds are presented in a reconciliation displayed further in our documentation. The District's major governmental funds are the general, building trades, 2002 debt service and 2005 capital projects funds.

### **Fiduciary Funds:**

The District is the Trustee, or fiduciary, for assets that belong to others. The District is responsible for ensuring that the assets reported in these funds are used only for their intended purposes, and only by those to whom the assets belong. We exclude these activities from the district-wide financial statements because the District cannot use these assets to finance its operations. The Student Activities Accounts are accounted for as fiduciary funds.

## The District as a Whole

Recall that the statement of net assets provides the perspective of the District as a whole. Table 1 provides a summary of the District's net assets as of June 30, 2006:

**TABLE 1**

	Governmental Activities 2004-2005	Governmental Activities 2005-2006	% Change
<b>Assets</b>			
Current and other assets	\$ 4,476,697	\$ 2,046,745	(54.3)
Capital assets	<u>7,582,020</u>	<u>9,631,846</u>	<u>27.0</u>
 Total assets	 <u>12,058,717</u>	 <u>11,678,591</u>	 <u>(3.2)</u>
<b>Liabilities</b>			
Current liabilities	1,688,766	1,807,439	7.0
Long-term liabilities	<u>7,850,698</u>	<u>7,446,709</u>	<u>(5.1)</u>
 Total liabilities	 <u>9,539,464</u>	 <u>9,254,148</u>	 <u>(3.0)</u>
<b>Net Assets</b>			
Invested in property and equipment - Net of related debt	(657,098)	1,793,587	373.0
Restricted	2,654,964	422,199	(84.1)
Unrestricted	<u>521,387</u>	<u>208,657</u>	<u>(60.0)</u>
 Total net assets	 <u>\$ 2,519,253</u>	 <u>\$ 2,424,443</u>	 <u>(3.8)</u>

The above analysis focuses on the net assets (see Table 1). The District's net assets were \$2,424,443 at June 30, 2006. Restricted net assets are reported separately to show legal constraints from debt covenants and enabling legislation that limit the District's ability to use those net assets for day-to-day operations. The District has \$422,199 restricted net assets. The remaining amount of net assets, \$208,657, was unrestricted.

The \$208,657 in unrestricted net assets of governmental activities represents the accumulated results of all past years' operations. It means that if we had to pay off all of our bills today, including all of our non-capital liabilities, we would have \$208,657 remaining. The operating results of the District will have a significant impact on the change in unrestricted net assets from year to year.

The results of this year's operations for the District as a whole are reported in the statement of activities (see Table 2), which shows the changes in net assets for fiscal year 2006.

**TABLE 2**

	Governmental Activities 2004-2005	Governmental Activities 2005-2006	% Change
Revenue			
Program Revenue			
Charges for services	\$ 194,896	\$ 186,105	(4.5)
Operating grants and contributions	448,011	523,054	16.8
General Revenue			
Property taxes	4,057,620	4,196,639	3.4
State School Aid-unrestricted	1,071,786	813,150	(24.1)
Other	246,173	681,599	176.9
Total revenues	<u>6,018,486</u>	<u>6,400,547</u>	<u>6.3</u>
Functions/Program Expenses			
Instruction	3,135,545	3,451,047	10.1
Support services	1,610,713	1,645,629	2.2
Food services	204,678	238,165	16.4
Athletics	153,114	160,325	4.7
Community services	15,626	9,611	(38.5)
Interest Expense	325,990	322,677	(1.0)
Other transactions	107,948	529,421	390.4
Depreciation (unallocated)	40,284	138,482	243.8
Total expenses	<u>5,593,898</u>	<u>6,495,357</u>	<u>16.1</u>
Change in net assets	<u>\$ 424,588</u>	<u>\$ (94,810)</u>	

As reported in the statement of activities, the cost of all of our governmental activities this year was \$6,495,357. Certain activities were partially funded from those who benefited from the programs, \$186,105, or by other grants and contributions of \$523,054. We paid for the remaining "public benefit" portion of our governmental activities with \$4,196,639 in taxes, \$813,150 in State Aid, and with our other revenues of \$681,599 which includes interest and general entitlements.

The District experienced a decrease in net assets of \$94,810 for the year. The key reasons for the change in net assets are the continuing poor economic condition of the State and increased depreciation expense.

As discussed above, the net cost shows the financial burden that was placed on the State and the District's taxpayers by each of these functions. Since property taxes for operations and unrestricted State Aid constitute the vast majority of District operating revenue sources, the School Board and Administration must annually evaluate the needs of the District and balance those needs with State prescribed available unrestricted resources.

### **The District's Funds**

As noted earlier, the District uses fund accounting to help it control and manage money for particular purposes. Looking at funds helps the reader consider whether the District is being accountable for the resources taxpayers and others provide to it and may provide more insight into the District's overall financial health. The District's budgets are prepared according to Michigan law. The most significant budgeted fund is the General Fund. The General Fund is the main operating fund of the District. All other funds would be used to account for the proceeds from specific revenue sources that are legally restricted to certain types of expenditures.

As the District completed this year, the governmental funds reported a combined fund balance of \$881,456, which is a decrease of \$2,379,384 from the prior year. The primary reason for the decrease was due to capital outlay purchases from the Capital Projects Fund.

### **Fund Budgetary Highlights**

Over the course of the year, the District revises its budget as it attempts to deal with numerous changes in expected revenues and expenditures. The Uniform Budget Act of the State of Michigan requires that the Board of Education adopt a budget for the upcoming school year prior to July 1, which is the start of the new fiscal year. The District revised its budget three times during the fiscal year. Under normal circumstances, the District adjusts its budget to reflect a wide variety of federal and state programs, many of which are not finalized until well after the District's original budget is required to be adopted.

A schedule showing the District's original and final budget amounts compared with amounts actually paid and received is provided in required supplemental information of these financial statements. Changes to the general fund budget were as follows:

- Final budgeted revenues were decreased by \$66,419 over the original budget once it became known that state aid would be lower than anticipated.
- Final budgeted expenditures decreased by \$152,167 from the original budget due to continued expenditure line adjustments. The District made a concerted effort to reduce the budget deficit throughout the year.



## Capital Asset and Debt Administration

### Capital Assets

At June 30, 2006, the District had \$9,631,846 invested in a range of capital assets including buildings, land, furniture, equipment and vehicles summarized as follows:

	<u>June 30, 2005</u>	<u>June 30, 2006</u>	<u>% Change</u>
Building and Improvements	\$1,179,539	\$10,237,497	767.9
Office Equipment	25,933	40,392	55.8
Equipment	5,923	19,970	237.2
Classroom Equipment	57,779	57,779	-
Food Service Equipment	13,489	-	(100.0)
Buses	545,627	351,075	(35.7)
Vehicles	51,492	51,492	-
Land	381,996	381,996	-
Construction in Process	6,898,156	-	(100.0)
 Total Capital Assets	 9,159,934	 11,140,201	 21.6
Less: Accumulated Depreciation	(1,577,914)	(1,508,355)	(4.4)
 Total capital assets, net	 <u>\$7,582,020</u>	 <u>\$ 9,631,846</u>	 <u>27.0</u>

### Long-term Debt

At June 30, 2006 the long-term debt ending balance was \$8,036,829. This was composed of \$6,170,000 in 2002 School Improvement Bonds; \$1,800,000 in 2005 School Improvement Bonds; (\$131,741) in unamortized financing costs; \$193,770 of early retirement incentive liabilities; and \$4,800 in accumulated leave liabilities. A summary of the change in long-term debt is as follows:

<u>Beginning Balance</u>	<u>New Debt</u>	<u>Payments</u>	<u>Ending Balance</u>
\$8,251,557	\$193,770	\$(408,498)	\$8,036,829

## **Economic Factors and Next Year's Budgets and Rates**

At the time these financial statements were prepared and audited, the District was aware of a number of circumstances that could significantly affect the financial health of Frankfort-Elberta Area Schools.

- The new retirement rate will increase to 17.74% from the 2005-06 rate of 16.34%. The increase in the retirement rate continues to be an issue for all districts in Michigan. A recent Senate Fiscal Agency report indicated that in reviewing the last three years, MPSERS contributions have increased by \$178 per pupil while foundation allowances increased by \$175. Unfortunately, future increases in MPSERS contributions will continue to cause districts to reduce funding for instructional purposes.
- Pressures on health insurance premiums are a continuing problem. The district has been experiencing double-digit increases.
- We continue to be very concerned about the State of Michigan's revenue picture. The State Aid bill for the 2006-2007 school year has been finalized with a \$210 increase in the base grant. Unfortunately, between increases in health insurance and retirement costs, very little will be available for classroom use.
- We are always seeking additional students to attend the District. Now more than ever, student count is important. Our number one revenue source is from the foundation allowance, which is driven by the number of students enrolled in the District.

## **Contacting the School District's Financial Management**

This financial report is designed to provide the District's citizens, taxpayers, customers, and investors and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact Barb Marshall, Business Manager, 534 11<sup>th</sup> St., Frankfort, MI 49635-9351. We can be reached by telephone at (231)352-4641.



Business and Financial Advisors  
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Thomas E. Gartland, CPA  
Brad P. Niergarth, CPA  
James G. Shumate, CPA  
Robert C. Thompson, CPA  
Michael D. Shaw, CPA  
Mary F. Krantz, CPA  
Shelly K. Bedford, CPA  
Heidi M. Wendel, CPA

## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Education  
Frankfort-Elberta Area Schools

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the **Frankfort-Elberta Area Schools** (the "School District") as of and for the year ended June 30, 2006, which collectively comprise the School District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the School District's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year comparative information has been derived from the School District's financial statements and, in our report dated August 25, 2005, we expressed an unqualified opinion on the respective financial statements of the governmental activities.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Frankfort-Elberta Area Schools as of June 30, 2006, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 28, 2006, on our consideration of the School District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

Member of



415 Munson Avenue, Post Office Box 947  
Traverse City, Michigan 49685-0947  
231.946.1722, FAX: 231.946.2762  
[www.dgncpa.com](http://www.dgncpa.com)

The management's discussion on pages i - viii and the budgetary comparison information on page 23, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the School District's basic financial statements. The combining non-major fund financial statements and other supplementary information on pages 25 - 28 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining non-major fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Dennis, Gartland & Niergarth*

August 28, 2006

# Frankfort - Elberta Area Schools

## STATEMENT OF NET ASSETS

June 30, 2006

(With comparative totals for June 30, 2005)

	Governmental Activities	
	2006	2005
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 605,636	\$ 684,444
Investments	1,001,151	3,016,021
Due from other governments	268,916	374,500
Prepaid expenses	-	7,363
Inventory	171,042	394,369
Total current assets	2,046,745	4,476,697
Non-current assets		
Capital assets, net of accumulated depreciation	9,631,846	7,582,020
Total assets	<u>\$ 11,678,591</u>	<u>\$ 12,058,717</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued expenses	\$ 260,212	\$ 746,165
Salaries payable and related expenses	452,421	460,089
Deferred revenue	4,686	1,653
Loans payable	500,000	80,000
Current portion of long-term debt	590,120	400,859
Total current liabilities	1,807,439	1,688,766
Non-current portion of long-term obligations	7,446,709	7,850,698
Total liabilities	<u>9,254,148</u>	<u>9,539,464</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	1,793,587	(657,098)
Restricted		
Debt Service	233,643	266,530
School-based activities	81,736	122,829
Capital Projects	106,820	2,265,605
Unrestricted	208,657	521,387
Total net assets	<u>2,424,443</u>	<u>2,519,253</u>
Total liabilities and net assets	<u>\$ 11,678,591</u>	<u>\$ 12,058,717</u>

The accompanying notes are an integral part of these statements.

# Frankfort - Elberta Area Schools

## STATEMENT OF ACTIVITIES

Year Ended June 30, 2006

(With comparative totals for June 30, 2005)

Functions/Programs	Expenses	Program Revenues		Net (Expense) Revenue and Changes in Net Assets	
		Charges for Services	Operating Grants and Contributions	Governmental Activities	2005
<b>Governmental activities</b>					
Instruction	\$ 3,451,047	\$ 79,876	\$ 346,601	\$ (3,024,570)	\$ (2,702,423)
Supporting Services	1,645,629	3,246	64,926	(1,577,457)	(1,609,513)
Community Services	9,611	10,912	-	1,301	(1,124)
Food Service	238,165	68,545	111,527	(58,093)	(32,315)
Athletics	160,325	23,526	-	(136,799)	(131,394)
Other transactions	529,421	-	-	(529,421)	(107,948)
Interest on long-term debt	322,677	-	-	(322,677)	(325,990)
Depreciation-unallocated	138,482	-	-	(138,482)	(40,284)
<b>Total governmental activities</b>	<b>\$ 6,495,357</b>	<b>\$ 186,105</b>	<b>\$ 523,054</b>	<b>(5,786,198)</b>	<b>(4,950,991)</b>
<b>General purpose revenues</b>					
Property taxes					
Levied for general purposes				3,492,150	3,378,152
Levied for Debt Service				704,489	679,468
State school aid - unrestricted				813,150	1,071,786
Grants and contributions not restricted to specific programs				436	16,474
Investment and other				681,163	229,699
<b>Total general purpose revenues</b>				<b>5,691,388</b>	<b>5,375,579</b>
<b>Change in net assets</b>				<b>(94,810)</b>	<b>424,588</b>
<b>Net assets - beginning of year</b>				<b>2,519,253</b>	<b>2,094,665</b>
<b>Net assets - end of year</b>				<b>\$ 2,424,443</b>	<b>\$ 2,519,253</b>

The accompanying notes are an integral part of these financial statements.

**Frankfort - Elberta Area Schools**  
**BALANCE SHEET - GOVERNMENTAL FUNDS**

June 30, 2006

(With comparative totals for June 30, 2005)

	General Fund	Building Trades	2002 Debt Service Fund	Capital Projects Fund 2005	Other Governmental Funds	Total Governmental Funds	
						2006	2005
<b>ASSETS</b>							
Cash and cash equivalents	\$ 472,314	\$ 89,211	\$ -	\$ -	\$ 44,111	\$ 605,636	\$ 684,444
Investments	423,678	-	274,106	189,669	113,698	1,001,151	3,016,021
Due from other governments and other receivables	263,612	-	-	-	5,304	268,916	374,500
Due from other funds	207,073	-	-	-	704	207,777	206,502
Prepaid expenses	-	-	-	-	-	-	7,363
Inventories - supplies and materials	-	170,797	-	-	245	171,042	394,369
<b>Total assets</b>	<b>\$ 1,366,677</b>	<b>\$ 260,008</b>	<b>\$ 274,106</b>	<b>\$ 189,669</b>	<b>\$ 164,062</b>	<b>\$ 2,254,522</b>	<b>\$4,683,199</b>
<b>LIABILITIES AND FUND BALANCES</b>							
<b>LIABILITIES</b>							
Accounts payable and accrued expenses	\$ 454,060	\$ -	\$ -	\$ 189,669	\$ 16,874	\$ 660,603	\$1,214,204
Note payable	500,000	-	-	-	-	500,000	-
Due to other funds	704	205,371	-	-	1,702	207,777	206,502
Deferred revenue	4,686	-	-	-	-	4,686	1,653
<b>Total liabilities</b>	<b>959,450</b>	<b>205,371</b>	<b>-</b>	<b>189,669</b>	<b>18,576</b>	<b>1,373,066</b>	<b>1,422,359</b>
<b>FUND BALANCES</b>							
Reserved for school-based activities	-	54,637	-	-	27,099	81,736	122,829
Reserved for Capital Projects	-	-	-	-	106,820	106,820	2,265,605
Reserved for Debt Service	-	-	274,106	-	11,567	285,673	338,580
Unreserved							
General Fund	407,227	-	-	-	-	407,227	533,826
<b>Total fund balances</b>	<b>407,227</b>	<b>54,637</b>	<b>274,106</b>	<b>-</b>	<b>145,486</b>	<b>881,456</b>	<b>3,260,840</b>
<b>Total liabilities and fund balances</b>	<b>\$ 1,366,677</b>	<b>\$ 260,008</b>	<b>\$ 274,106</b>	<b>\$ 189,669</b>	<b>\$ 164,062</b>		

**Reconciliation of Governmental Fund Balances to District-Wide Government Activities Net Assets**

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported as assets in governmental funds. The cost of the assets is \$11,140,201 and the accumulated depreciation is \$1,508,355.

9,631,846      7,582,020

Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported as liabilities in the funds. Long-term liabilities at year-end consist of:

Bonds payable	(7,970,000)	(8,390,000)
Unamortized financing costs	131,741	150,882
Accrued interest on bonds	(52,030)	(72,050)
Accrued early retirement incentive liability	(193,770)	-
Accumulated leave liability	(4,800)	(12,439)

Total net assets - governmental activities

\$ 2,424,443      \$2,519,253

The accompanying notes are an integral part of these financial statements.

# Frankfort - Elberta Area Schools

## STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS

Year Ended June 30, 2006

(With comparative totals for June 30, 2005)

	General Fund	Building Trades	2002 Debt Service Fund	Capital Projects Fund 2005	Other Governmental Funds	Total Governmental Funds
<b>Revenues</b>						
Property taxes	\$ 3,492,150	\$ -	\$ 605,561	\$ -	\$ 98,928	\$ 4,196,639
Interest	24,819	-	4,978	14,776	5,097	49,670
State revenues	1,097,452	-	-	-	12,788	1,110,240
Federal revenues	127,661	-	-	-	98,739	226,400
Other	353,384	370,900	315	250	92,749	817,598
<b>Total revenues</b>	<b>5,095,466</b>	<b>370,900</b>	<b>610,854</b>	<b>15,026</b>	<b>308,301</b>	<b>6,400,547</b>
<b>Expenditures</b>						
Instruction	3,262,777	-	-	-	-	3,262,777
Supporting Services	1,647,411	-	-	-	-	1,647,411
Community Services	9,611	-	-	-	-	9,611
Other transactions	43,348	-	-	2,975	2,128	48,451
Food Service	-	-	-	-	238,340	238,340
Athletics	-	-	-	-	160,507	160,507
Debt Service	-	-	-	-	-	-
Principal	-	-	420,000	-	-	420,000
Interest	-	-	253,103	-	89,594	342,697
Capital outlay	34,663	435,479	-	1,682,079	497,916	2,650,137
<b>Total expenditures</b>	<b>4,997,810</b>	<b>435,479</b>	<b>673,103</b>	<b>1,685,054</b>	<b>988,485</b>	<b>8,779,931</b>
<b>REVENUES OVER (UNDER) EXPENDITURES</b>	<b>97,656</b>	<b>(64,579)</b>	<b>(62,249)</b>	<b>(1,670,028)</b>	<b>(680,184)</b>	<b>(4,252,366)</b>
Other financing sources (uses)						
Proceeds from bond issue	-	-	-	-	-	-
Operating transfers in	-	-	8,872	8,700	331,299	348,871
Operating transfers out	(224,255)	-	(2,495)	(103,002)	(19,119)	(348,871)
<b>Total other financing sources (uses)</b>	<b>(224,255)</b>	<b>-</b>	<b>6,377</b>	<b>(94,302)</b>	<b>312,180</b>	<b>-</b>
<b>REVENUES UNDER EXPENDITURES</b>	<b>(126,599)</b>	<b>(64,579)</b>	<b>(55,872)</b>	<b>(1,764,330)</b>	<b>(368,004)</b>	<b>(2,379,384)</b>
<b>AND OTHER FINANCING SOURCES (USES)</b>	<b>533,826</b>	<b>119,216</b>	<b>329,978</b>	<b>1,764,330</b>	<b>513,490</b>	<b>3,260,840</b>
Fund balance, beginning of year						
Fund balance, end of year	\$ 407,227	\$ 54,637	\$ 274,106	\$ -	\$ 145,486	\$ 881,456
						\$ 3,260,840

The accompanying notes are an integral part of these financial statements.



# Frankfort - Elberta Area Schools

## RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES WITH THE DISTRICT-WIDE STATEMENT OF ACTIVITIES

Year Ended June 30, 2006

(With comparative totals for June 30, 2005)

	<u>2006</u>	<u>2005</u>
<b>Total net change in fund balances - governmental funds</b>	<b>\$ (2,379,384)</b>	<b>\$ (2,470,407)</b>
Amounts reported for governmental activities in the statement of activities are different because:		
Capital outlays to purchase or build capital assets are reported in the governmental funds as expenditures. However, for governmental activities those costs are shown in the statement and allocated over their estimated useful lives as annual depreciation expenses in the statement of activities. This is the amount by which capital outlays exceeds depreciation in the period.		
Capital outlays	\$ 2,188,308	
Depreciation expense	<u>(138,482)</u>	
	2,049,826	4,389,899
In the statement of activities, certain operating expenses - compensated absences - are measured by the amounts earned during the year. In the governmental funds, however, expenditures for these items are measured by the amount of financial resources used (essentially, the amounts actually paid). This year, compensated absences paid out were more than amounts earned by \$7,639.		
	7,639	(1,266)
In the statement of activities, certain operating expenses - early retirement incentives - are measured by the amounts earned during the year. In the governmental funds, however, expenditures for these items are measured by the amount of financial resources used (essentially, the amounts actually paid). This year, early retirement incentive benefits earned were \$193,770.		
	(193,770)	-
Repayment of bond principal is an expenditure in the governmental funds, but it reduces long-term liabilities in the statement of net assets and does not affect the statement of activities.		
	420,000	370,000
Some of the capital assets acquired this year were financed with bond proceeds. The amount financed by the bond proceeds is reported in the governmental funds as a source of financing. On the other hand, the bond proceeds are not revenues in the statement of activities, but rather constitute long-term liabilities in the statement of net assets.		
	-	(1,800,000)
Amortization of deferred financing costs.		
	(19,141)	(18,588)
Issuance costs are a reduction of bond proceeds in the governmental funds, but are amortized over the life of the bonds in the district-wide statements.		
	-	27,000
Interest on long-term debt in the statement of activities differs from the amount reported in the governmental funds, because interest is recorded as an expenditure in the funds when it is due, and thus requires the use of current financial resources. In the statement of activities, however, interest expense is recognized as the interest accrues, regardless of when it is due. The reduced amount of interest reported in the statement of activities is the net result of the decrease in accrued interest on bonds payable.		
	<u>20,020</u>	<u>(72,050)</u>
<b>Change in net assets of governmental activities</b>	<b><u>\$ (94,810)</u></b>	<b><u>\$ 424,588</u></b>

The accompanying notes are an integral part of these financial statements.

# Frankfort - Elberta Area Schools

## STATEMENT OF FIDUCIARY NET ASSETS

June 30, 2006

(With comparative totals for June 30, 2005)

	Agency Funds	
	2006	2005
<b>ASSETS</b>		
Cash and cash equivalents	<u>\$ 68,958</u>	<u>\$ 80,849</u>
<b>LIABILITIES</b>		
Due to student groups	<u>\$ 68,958</u>	<u>\$ 80,849</u>

The accompanying notes are an integral part of these financial statements.

# **Frankfort - Elberta Area Schools**

## **NOTES TO FINANCIAL STATEMENTS**

### **NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### ***Introduction***

Frankfort-Elberta Area Schools (the "School District") is a Michigan public school district consisting of one elementary school and a junior and senior high school. The School District primarily serves the Benzie County area. As of June 30, 2006, the School District employed 43 professional staff and 22 non-professional staff and has approximately 600 students enrolled within its School District.

The accounting policies of the School District conform to generally accepted accounting principles as applicable to governments. The School District is considered to be a local government unit.

The accounting and reporting framework and the more significant accounting principles and practices of Frankfort-Elberta Area Schools are discussed in subsequent sections of this note. The remainder of the notes are organized to provide explanations, including required disclosures, of the School District's financial activities for the fiscal year ended June 30, 2006.

#### ***The Financial Reporting Entity***

Frankfort-Elberta Area School's Board of Education (the "Board") is the basic level of government which has oversight responsibility and control over all activities related to the public school education. The Board receives funding from local, State and Federal governmental sources and must comply with the concomitant requirements of these funding source entities. However, the Board is not included in any other governmental "reporting entity" as defined in Governmental Accounting Standards Board ("GASB") Statement No. 14, since Board members are elected by the public and have decision-making authority to levy taxes, the power to designate management, the ability to significantly influence operations and primary accountability for fiscal matters. In addition, under the criteria of the GASB pronouncements, student, parent and teacher organizations are not included, except to the extent that the schools hold assets in the capacity of an agent.

#### ***Government-Wide and Fund Financial Statements***

##### ***Government-Wide Financial Statements***

The statement of net assets and statement of activities display information about the School District as a whole, except for its fiduciary activities. Individual funds are not displayed but the statements distinguish governmental activities, generally supported by taxes and School District general revenues, from business-type activities, generally financed in whole or in part with fees charged to external customers.

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

The statement of activities reports the expenses of a given function offset by program revenues directly connected with the functional program. A function is an assembly of similar activities and may include portions of a fund or summarize more than one fund to capture the expenses and program revenues associated with a distinct functional activity. Program revenues include: (1) charges for services which report fees, fines and forfeitures, and other charges to users of the School District's services; (2) operating grants and contributions which finance annual operating activities including restricted investment income; and (3) capital grants and contributions which fund the acquisition, construction or rehabilitation of capital assets. These revenues are subject to externally imposed restrictions to these program uses. Taxes and other revenue sources not properly included with program revenues are reported as general revenues.

*Fund Financial Statements*

The balance sheet and statement of revenues, expenditures and changes in fund balances (i.e., fund financial statements) for the School District's governmental funds are presented after the government-wide statements. These statements display information about major funds individually and non-major funds in the aggregate for governmental funds. Major funds are generally those that represent 10% or more of governmental fund assets, liabilities, revenues or expenditures.

*Measurement Focus, Basis of Accounting and Financial Statement Presentation*

The financial statements of the School District are prepared in accordance with generally accepted accounting principles ("GAAP"). The School District's reporting entity applies all relevant Governmental Accounting Standards Board ("GASB") pronouncements and applicable Financial Accounting Standards Board ("FASB") pronouncements and Accounting Principles Board ("APB") opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The School District's reporting entity does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

The government-wide statements report using the economic resources measurement focus and the accrual basis of accounting generally including the reclassification or elimination of internal activity (between or within funds). Reimbursements are reported as reductions to expenses. Fiduciary fund financial statements also report using this same focus and basis of accounting, although internal activity is not eliminated in these statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized in the year for which they are levied while grants are recognized when grantor eligibility requirements are met.

Governmental fund financial statements report using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are both measurable and available. Available means collectible within the current period or soon enough thereafter to pay current liabilities. The School District considers revenues to be available if they are collected within 60 days of the end of the fiscal year. Expenditures are recorded when the related fund liability is incurred, except for general obligation bond principal and interest which are reported as expenditures in the year due.

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

Major revenue sources susceptible to accrual include property taxes, intergovernmental revenues and investment income. In general, other revenues are recognized when cash is received.

***Fund Types and Major Funds***

***Activities in Major Funds***

The General Fund is the general operating fund of the School District. It is used to account for all financial resources except those required to be accounted for in another fund.

The Building Trades Fund is a Special Revenue Fund used to account for financial resources used to construct homes for resale and proceeds from the sale of the homes.

The 2002 Debt Service Fund is used to account for the accumulation of resources for and the payment of, bond principal, interest and related costs.

The 2005 Capital Projects Fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

***Other Governmental Funds***

The Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for special purposes. The Food Service and Athletic Funds are accounted for as Special Revenue Funds.

The Debt Service Funds are used to account for the accumulation of resources for, and the payment of, bond principal, interest and related costs.

The 2002 Capital Projects Fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

***Fiduciary Fund Types***

***Agency Fund***

The Agency Fund accounts for assets held by the School District as an agent for individuals, private organizations, other governments or other funds. Agency Funds are custodial in nature (assets equal liabilities) and do not involve measurements of results of operations. The Student Activity Fund is an Agency Fund.

***Cash and Investments***

The School District reporting entity considers highly liquid investments (including restricted assets) with an original maturity of three months or less when purchased to be cash equivalents.

## NOTES TO FINANCIAL STATEMENTS - Continued

### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Investments are reported at fair value which is determined using selected bases. Short-term investments are reported at cost, which approximates fair value. Cash deposits are reported at carrying amount, which reasonably estimates fair value.

#### ***Inventories***

Inventories in governmental funds consist of expendable supplies held for consumption stated on a first-in, first-out basis and homes constructed for resale. They are reported at cost, which is recorded as an expenditure at the time individual inventory items are used or sold.

#### ***Capital Assets***

Capital assets are recorded at cost or, if donated, the fair value at the time of donation. Capital assets are depreciated over their estimated useful lives ranging from 3 to 50 years. The School District generally capitalizes assets with cost of \$5,000 or more as purchase and construction outlays occur. No depreciation is recorded on land. Expenditures for major renewals and betterments that extend the useful lives of the capital assets are capitalized. Expenditures for maintenance and repairs are charged to current expenditures as incurred. Depreciation is computed using the straight-line method. When capital assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts and the resulting gain or loss is recorded in operations.

Estimated useful lives, in years, for depreciable assets are as follows:

Buildings	25-50
Improvements, other than buildings	15-20
Vehicles	7-10
Furniture, machinery and equipment	3-20

#### ***Long-Term Debt, Deferred Debt Expense and Bond Discounts/Premiums***

In the government-wide financial statements, outstanding debt is reported as liabilities. Bond issuance costs, bond discounts or premiums, and the difference between the reacquisition price and the net carrying value of refunded debt are capitalized and amortized over the terms of the respective bonds using a method that approximates the effective interest method.

The governmental fund financial statements recognize the proceeds of debt and premiums as other financing sources of the current period. Issuance costs are reported as expenditures.

#### ***Fund Equity***

The governmental fund financial statements report reserved fund balances for amounts not available for appropriation or legally restricted for specified purposes.

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

***Encumbrance Accounting***

The School District formally records encumbrances in the accounting records during the year as a normal practice. In accordance with generally accepted accounting principles, outstanding encumbrances at year-end for which goods or services are received are reclassified as expenditures and accounts payable. All other encumbrances in the annual budgeted funds are reversed at year-end and are either canceled or are included as reappropriations of fund balance for the subsequent year.

***Use of Estimates in the Preparation of Financial Statements***

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates.

***Allocation of Expenses***

The School District reports each function's direct expenses, those that are specifically associated with a service, program or department and, thus, are clearly identifiable to a particular function.

The School District has elected to not allocate indirect expenses.

***Program Revenues***

Program revenues derive directly from the program itself or from outside parties for the restricted use in a particular program. On the statement of activities, program revenues reduce the net cost of the various functions to reflect the amount which is financed from the School District's general revenues.

The School District's most significant program revenues are Title I, At-Risk and School Lunch Programs, which are reported as operating grants and contributions.

***Spending Policy***

The School District's policy is to apply restricted revenues first when an expense is incurred for purposes when both restricted and unrestricted net assets are available.

**NOTE B - BUDGETARY POLICY AND PRACTICE**

***Excess of Expenditures over Appropriations in Budgeted Funds***

Michigan Public Act 621 of 1978 provides that a local unit shall not incur expenditures in excess of the amounts appropriated. During the year ended June 30, 2006, the School District incurred no expenditures which were in excess of the amounts appropriated as reflected in the budgetary comparison schedule.

NOTES TO FINANCIAL STATEMENTS - Continued

**NOTE C - CASH AND INVESTMENTS**

At June 30, 2006, the School District's cash and investments include the following:

	Balance Sheet Classification		
	Cash and Equivalents	Investments	Total
Bank deposits and cash on hand	\$605,636	\$ -	\$ 605,636
CD, bond and money market investments	68,958	285,695	354,653
Investment pools	-	715,456	715,456
	<u>\$674,594</u>	<u>\$1,001,151</u>	<u>\$1,675,745</u>

*Custodial Credit Risk - Deposits*

In the event of a bank failure, the School District's deposits may not be returned to it. As of June 30, 2006, \$174,004 of the School District's cash and investments was insured. The remaining bank balance of \$1,538,672 was exposed to custodial credit risk because it was uninsured and uncollateralized.

*Investments*

Michigan law permits investments in the following vehicles:

1. Bonds and other obligations of the United States Government.
2. Certificates of deposit and savings accounts of banks or credit unions who are members of the FDIC and FSLIC, respectively.
3. Certain commercial paper.
4. United States Government repurchase agreements.
5. Banker's acceptance of United States banks.
6. Certain mutual funds.

Investment Type	Investment Maturities (in years)				
	Fair Value	Current	1-5	6-10	More than 10
Money market accounts	\$ 354,653	\$ 354,653	\$ -	\$ -	\$ -
Investment pools	<u>715,456</u>	<u>715,456</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$1,070,109</u>	<u>\$1,070,109</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

*Interest Rate Risk*

In accordance with the School District's investment policy, the School District will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by: structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market; and, investing operating funds primarily in short-term securities, liquid asset funds, money market funds, or similar investment pools and limiting the average maturity in accordance with the School District's cash requirements.



## NOTES TO FINANCIAL STATEMENTS - Continued

### NOTE C - CASH AND INVESTMENTS - Continued

#### *Credit Risk*

State law limits investments in commercial paper and corporate bonds to a prime or better rating issued by nationally recognized rating organizations. The School District has no investment policy that would further limit its investment choices. The School District's investments in the MILAF and Government Sponsored Enterprises investment pools were rated AAAM and AAA, respectively, by Standard & Poor's.

### NOTE D - RECEIVABLES, UNCOLLECTIBLE ACCOUNTS AND DEFERRED REVENUE

#### *Property Taxes Receivable, Deferred Revenue and Property Tax Calendar*

Property taxes are levied, billed and attached as enforceable liens on July 1 of the School District's fiscal year. Townships within the School District collect and remit taxes until September 15, at which time the uncollected real property taxes are turned over to the counties as delinquent. Delinquent real property taxes are funded by the county and remitted to the School District. Delinquent personal property tax remains a receivable until collected from the taxpayer by the townships and remitted to the School District. In the governmental fund financial statements, if delinquent taxes are not paid within 60 days of year-end, they are recorded as deferred revenue. In the government-wide financial statements, property taxes receivable and related revenue include all amounts due the School District regardless of when cash is received. Over time, substantially all property taxes are collected.

During the fiscal year, \$18.00 per \$1,000 of equalized non-homestead property value in the School District of \$196,070,370 was levied for general operating purposes. For Debt Service purposes, \$2.35 per \$1,000 of equalized homestead and non-homestead property value in the School District of \$299,684,880 was levied.

#### *Intergovernmental Receivables and Deferred Revenue*

Intergovernmental receivables are primarily comprised of amounts due from the State and Federal governments. Revenue is recorded as earned when eligibility requirements are met. Grant revenues deferred in the governmental fund financial statements include unearned revenue and revenue received more than 60 days following year-end (unavailable to pay liabilities of the current period). Deferred revenue received after 60 days is fully recognized as revenue in the government-wide statements if grantor eligibility requirements are met.

Amounts due from other governments at June 30, 2006 are as follows:

Due from the State of Michigan	
State Aid	\$ 208,384
Due from Federal grants	50,316
Due from townships - property taxes	2,851
Other receivables	7,365
	<u>\$ 268,916</u>

NOTES TO FINANCIAL STATEMENTS - Continued

**NOTE E - INVESTMENTS IN CAPITAL ASSETS**

Investments in capital assets consist of the following:

	Balance June 30, 2005	Additions	Deletions	Balance June 30, 2006
Building and improvements	\$1,179,539	\$9,057,958	\$ -	\$10,237,497
Office equipment	25,933	14,459	-	40,392
Equipment	5,923	14,047	-	19,970
Classroom equipment	57,779	-	-	57,779
Food service equipment	13,489	-	(13,489)	-
Buses	545,627	-	(194,552)	351,075
Vehicles	<u>51,492</u>	<u>-</u>	<u>-</u>	<u>51,492</u>
Total	1,879,782	9,086,464	(208,041)	10,758,205
Less accumulated depreciation	(1,577,914)	(138,482)	208,041	(1,508,355)
Land	381,996	-	-	381,996
Construction in process	<u>6,898,156</u>	<u>-</u>	<u>(6,898,156)</u>	<u>-</u>
Total capital assets, net	<u>\$7,582,020</u>	<u>\$8,947,982</u>	<u>\$(6,898,156)</u>	<u>\$ 9,631,846</u>

Depreciation expense of \$138,482 was unallocated.

**NOTE F - LONG-TERM LIABILITIES**

Changes in long-term debt during the year ended June 30, 2006 were as follows:

	Beginning Balance	New Debt	Payments	Ending Balance	Current Portion
General obligation bonds	\$8,390,000	\$ -	\$ (420,000)	\$7,970,000	\$510,000
Unamortized financing costs	(150,882)	-	19,141	(131,741)	(18,265)
Early retirement incentive	-	193,770	-	193,770	96,885
Compensated absences	<u>12,439</u>	<u>-</u>	<u>(7,639)</u>	<u>4,800</u>	<u>1,500</u>
Long-term debt at June 30, 2006	<u>\$8,251,557</u>	<u>\$193,770</u>	<u>\$ (408,498)</u>	<u>\$8,036,829</u>	<u>\$590,120</u>

Payments on general obligation bonds are made by the Debt Service Fund. The early retirement incentive and accumulated leave liability will be liquidated primarily from the General Fund.

NOTES TO FINANCIAL STATEMENTS - Continued

**NOTE F - LONG-TERM LIABILITIES - Continued**

At June 30, 2006, the School District's long-term debt consisted of the following:

2002 School Improvement Bonds. Due in annual installments of \$295,000 to \$685,000 through May 1, 2017; average interest rate of 4.05%.	\$6,170,000
2005 School Improvement Bonds. Due in annual installments of \$65,000 to \$160,000 through May 1, 2024; average interest rate of 4.23%.	1,800,000
Unamortized financing costs	(131,741)
Early retirement incentive liability, due in annual installments of \$32,295 to \$96,885 through July 1, 2008	193,770
Accumulated leave liability	<u>4,800</u>
Total long-term debt	<u>\$8,036,829</u>

Total annual requirements to amortize bonds as of June 30, 2006 are as follows:

<u>Years Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 510,000	\$ 312,178
2008	530,000	296,487
2009	550,000	279,035
2010	575,000	259,963
2011	600,000	239,007
2012-2016	3,410,000	818,295
2017-2021	1,320,000	216,005
2022-2024	<u>475,000</u>	<u>40,827</u>
Totals	<u>\$7,970,000</u>	<u>\$ 2,461,797</u>

Interest expense for the year ended June 30, 2006 was \$322,677 and interest paid for the year ended June 30, 2006 was \$342,697.

**NOTE G - RISK MANAGEMENT**

The School District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; unemployment benefits; and natural disasters. The School District manages its risk exposures and provides certain employee benefits through a combination of self-insurance and risk management pools.

## NOTES TO FINANCIAL STATEMENTS - Continued

### NOTE G - RISK MANAGEMENT - Continued

The School District pays unemployment claims on a reimbursement basis.

The School District participates in SET-SEG's risk management pools for worker's compensation claims, liability insurance and errors and omissions coverages. SET-SEG was established pursuant to laws of the State of Michigan which authorize local units of government to jointly exercise any power, privilege or authority which each might exercise separately. The purpose of SET-SEG is to provide cooperative and comprehensive risk financing and risk control services. SET-SEG provides risk management, underwriting, reinsurance and claim review and processing services for all member governments pursuant to its charter.

The School District makes annual contributions to SET-SEG based on actuarial studies using historical data and insurance industry statistics. These contributions are paid from the General Fund. Such contributions as received by SET-SEG's General Fund are expended for reinsurance coverage, claim payments and certain general and administrative costs, whereas resources in the Member Retention Fund are used for loss payments and defense costs up to the member's self-insurance retention limits along with certain other member-specific costs. Any refunds from SET-SEG are deposited in the School District's General Fund.

### NOTE H - BALANCES AND TRANSFERS/PAYMENTS WITHIN THE REPORTING ENTITY

#### *Receivables and Payables*

Outstanding balances between funds reported as "due to/from other funds" include outstanding charges by one fund to another for services or goods, subsidy commitments outstanding at year-end and other miscellaneous receivables/payables between funds.

Interfund receivables and payables as reported in the governmental fund financial statements at June 30, 2006 are as follows:

<u>Fund</u>	<u>Interfund Receivable</u>	<u>Interfund Payable</u>
General Education	\$207,073	\$ 704
Athletics	-	774
Building Trades	-	205,371
Food Service	<u>704</u>	<u>928</u>
	<u>\$207,777</u>	<u>\$207,777</u>

#### *Transfers and Payments*

Transfers and payments within the reporting entity are substantially for the purposes of subsidizing operating functions, funding capital projects and asset acquisitions or maintaining debt service on a routine basis. Resources are accumulated in a fund to support and simplify the administration of various projects or programs.

# NOTES TO FINANCIAL STATEMENTS - Continued

## NOTE H - BALANCES AND TRANSFERS/PAYMENTS WITHIN THE REPORTING ENTITY - Continued

The government-wide statement of activities eliminates transfers as reported within the segregated governmental and business-type activities columns. Only transfers between the two columns appear in this statement.

The following schedule reports transfers and payments within the reporting entity:

<u>Transfer in</u>	<u>Amount</u>	<u>Transfers out</u>	<u>Amount</u>
Other Governmental Funds		Other Governmental Funds	
Athletic Fund	\$148,321	Debt Service 2000	\$ 8,872
Food Service Fund	75,934	Capital Projects 2000	10,247
Debt Service 2005	2,495	Major Governmental Funds	
Capital Projects 2002	104,549	General Fund	224,255
Major Governmental Funds		Debt Service 2002	2,495
Debt Service 2002	8,872	Capital Projects 2005	103,002
Capital Projects 2005	<u>8,700</u>		
	<u>\$348,871</u>		<u>\$348,871</u>

## NOTE I - PENSION PLAN

The School District contributes to the Michigan Public School Employees' Retirement Systems ("MPERS"), a cost-sharing multiple-employer defined benefit pension plan administered by the State of Michigan, Department of Management & Budget ("DMB"). MPERS provides retirement, disability, death and post-employment health benefits to plan members and beneficiaries. Member Investment Plan ("MIP") participants receive enhanced benefits compared to Basic Plan participants. Benefits are safeguarded by Article IX, Section 24 of the Michigan Constitution. Public Act 300 of 1980, as amended, assigns authority to establish and amend benefit provisions to the State Legislature. MPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to MPERS, P.O. Box 30171, Lansing, MI 48909, by calling (517) 322-5103, or on the State of Michigan's website @ [www.michigan.gov](http://www.michigan.gov).

### *Funding Policy*

Plan members who participate in MIP are required to contribute 3.0% to 4.5% of their annual covered salary; plan members who participate in the Basic Plan may not contribute to the plan; and the School District is required to contribute at an actuarially determined rate for all participants. The rate was 14.87% for July 1, 2005 through September 30, 2005 and 16.34% for October 1, 2005 through June 30, 2006 of annual covered payroll. The contribution requirements of plan members and the School District are established and may be amended by the State Legislature. The School District's contributions to MPERS for the year ended June 30, 2006, 2005 and 2004 was \$450,882, \$407,575 and \$384,080, respectively, equal to the required contribution for each year.

**NOTE J - COMMITMENTS AND CONTINGENCIES**

***Collectively Bargained Employment Agreements***

The teachers of the School District are organized under the Frankfort-Elberta Education Association. The Board of Education and the Frankfort-Elberta Education Association have a contract for the year ending June 30, 2007 giving teachers an increase of 1.5%.

***Federal and State Grants***

In the normal course of operations, the School District receives grant funds from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authorities, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

***Construction Commitments***

During the years ended June 30, 2002 and 2005, the School District issued bonds in the amounts of \$7,590,000 and \$1,800,000, respectively, for the purpose of remodeling, reequipping and refurbishing school facilities. As of June 30, 2006, these projects were substantially complete. Remaining costs, estimated to be \$17,000, will be paid by the General Fund.

## **REQUIRED SUPPLEMENTARY INFORMATION**

# Frankfort - Elberta Area Schools

## BUDGETARY COMPARISON SCHEDULE FOR THE GENERAL FUND

For the Year Ended June 30, 2006

(With comparative totals for June 30, 2005)

	Budgeted Amounts		Actual (GAAP Basis) 2006	Variances - Positive (Negative)		Actual (GAAP Basis) 2005
	Original	Final		Original to Final	Final to Actual Total	
<b>Revenues</b>						
Local and intermediate sources	\$ 3,579,051	\$ 3,738,119	\$ 3,754,781	\$ 159,068	\$ 16,662	\$ 3,548,174
State revenues	1,296,280	1,088,084	1,097,452	(208,196)	9,368	1,276,683
Federal revenues	135,512	128,138	127,661	(7,374)	(477)	148,950
Incoming transfers and other transactions	105,871	95,954	115,572	(9,917)	19,618	95,031
<b>Total revenues</b>	<b>5,116,714</b>	<b>5,050,295</b>	<b>5,095,466</b>	<b>(66,419)</b>	<b>45,171</b>	<b>5,068,838</b>
<b>Expenditures</b>						
Instruction	3,310,763	3,304,142	3,269,904	6,621	34,238	3,140,318
Supporting Services	1,558,551	1,713,479	1,674,447	(154,928)	39,032	1,612,518
Community Services	10,810	12,911	9,611	(2,101)	3,300	15,626
Payments to other governmental agencies, facility acquisitions and prior period adjustments						
Payments to other governmental agencies	50,500	51,759	43,348	(1,259)	8,411	49,854
Facility acquisitions	-	500	500	(500)	-	-
<b>Total expenditures</b>	<b>4,930,624</b>	<b>5,082,791</b>	<b>4,997,810</b>	<b>(152,167)</b>	<b>84,981</b>	<b>4,818,316</b>
<b>REVENUES OVER (UNDER) EXPENDITURES</b>	<b>186,090</b>	<b>(32,496)</b>	<b>97,656</b>	<b>(218,586)</b>	<b>130,152</b>	<b>250,522</b>
Other financing sources (uses)						
Operating transfers out	(186,090)	(224,254)	(224,255)	(38,164)	(1)	(136,601)
<b>REVENUES OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)</b>	<b>-</b>	<b>(256,750)</b>	<b>(126,599)</b>	<b>(256,750)</b>	<b>130,151</b>	<b>113,921</b>
Fund balance, beginning of year	454,269	533,826	533,826	79,557	-	419,905
Fund balance, end of year	\$ 454,269	\$ 277,076	\$ 407,227	\$ (177,193)	\$ 130,151	\$ 533,826



**COMBINING FINANCIAL STATEMENTS OF  
NON-MAJOR GOVERNMENTAL FUNDS**

# Frankfort - Elberta Area Schools

## COMBINING BALANCE SHEET - NON-MAJOR GOVERNMENTAL FUNDS

June 30, 2006

(With comparative totals for June 30, 2005)

	Special Revenue Funds		Capital Projects Fund		Debt Service Funds		Total Non-Major Governmental Funds	
	Food Service	Athletics	2000	2002	Public Improvement	2000	2005	2006
<b>ASSETS</b>								
Cash and cash equivalents	\$ 24,120	\$ 8,424	\$ -	\$ -	\$ -	\$ -	\$ 11,567	\$ 44,111
Investments	-	-	-	6,878	106,820	-	-	113,698
Due from other governments and other receivables	5,304	-	-	-	-	-	-	5,304
Due from other funds	704	-	-	-	-	-	-	704
Inventories - supplies and materials	245	-	-	-	-	-	-	245
Total assets	\$ 30,373	\$ 8,424	\$ -	\$ 6,878	\$ 106,820	\$ -	\$ 11,567	\$ 164,062
								\$ 135,596
<b>LIABILITIES AND FUND BALANCES</b>								
<b>LIABILITIES</b>								
Accounts payable and accrued expenses	\$ 9,996	\$ -	\$ -	\$ 6,878	\$ -	\$ -	\$ -	\$ 16,874
Due to other funds	928	774	-	-	-	-	-	1,702
Total liabilities	10,924	774	-	6,878	-	-	-	18,576
								8,774
<b>FUND BALANCES</b>								
Reserved for school-based activities	19,449	7,650	-	-	-	-	-	27,099
Reserved for Capital Projects	-	-	-	-	106,820	-	-	106,820
Reserved for Debt Service	-	-	-	-	-	-	11,567	11,567
Total fund balances	19,449	7,650	-	-	106,820	-	11,567	145,486
Total liabilities and fund balances	\$ 30,373	\$ 8,424	\$ -	\$ 6,878	\$ 106,820	\$ -	\$ 11,567	\$ 164,062
								\$ 135,596

# Frankfort - Elberta Area Schools

## COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - NON-MAJOR GOVERNMENTAL FUNDS

Year Ended June 30, 2006

	Special Revenue Funds		Capital Projects Funds			Debt Service Funds		Total Non-Major Governmental Funds	
	Food Service	Athletics	2000	2002	Public Improvement	2000	2005	2006	2005
<b>Revenues</b>									
Property taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 98,928	\$ 98,928	\$ -
Interest	-	-	49	628	4,089	284	47	5,097	2,108
State revenues	12,788	-	-	-	-	-	-	12,788	8,639
Federal revenues	98,739	-	-	-	-	-	-	98,739	85,525
Other	69,171	23,526	-	-	-	-	52	92,749	99,919
<b>Total revenues</b>	<b>180,698</b>	<b>23,526</b>	<b>49</b>	<b>628</b>	<b>4,089</b>	<b>284</b>	<b>99,027</b>	<b>308,301</b>	<b>196,191</b>
<b>Expenditures</b>									
Food Services	238,340	-	-	-	-	-	-	238,340	204,652
Athletics	-	160,507	-	-	-	-	-	160,507	153,084
Other transactions	-	-	-	75	1,678	-	375	2,128	-
Debt Service	-	-	-	-	-	-	-	-	-
Interest	1,997	4,149	-	491,770	-	-	89,594	89,594	-
Capital outlay	-	-	-	-	-	-	-	497,916	-
<b>Total expenditures</b>	<b>240,337</b>	<b>164,656</b>	<b>-</b>	<b>491,845</b>	<b>1,678</b>	<b>-</b>	<b>89,969</b>	<b>988,485</b>	<b>357,736</b>
<b>REVENUES OVER (UNDER) EXPENDITURES</b>	<b>(59,639)</b>	<b>(141,130)</b>	<b>49</b>	<b>(491,217)</b>	<b>2,411</b>	<b>284</b>	<b>9,058</b>	<b>(680,184)</b>	<b>(161,545)</b>
Other financing sources (uses)									
Operating transfers in	75,934	148,321	-	104,549	-	-	2,495	331,299	136,601
Operating transfers out	-	-	(10,247)	-	-	(8,872)	-	(19,119)	-
<b>Net other financing sources (uses)</b>	<b>75,934</b>	<b>148,321</b>	<b>(10,247)</b>	<b>104,549</b>	<b>-</b>	<b>(8,872)</b>	<b>2,495</b>	<b>312,180</b>	<b>136,601</b>
<b>REVENUES OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)</b>	<b>16,295</b>	<b>7,191</b>	<b>(10,198)</b>	<b>(386,668)</b>	<b>2,411</b>	<b>(8,588)</b>	<b>11,553</b>	<b>(368,004)</b>	<b>(24,944)</b>
Fund balance, beginning of year	3,154	459	10,198	386,668	104,409	8,588	14	513,490	151,766
<b>Fund balance, end of year</b>	<b>\$ 19,449</b>	<b>\$ 7,650</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 106,820</b>	<b>\$ -</b>	<b>\$ 11,567</b>	<b>\$ 145,486</b>	<b>\$ 126,822</b>

## **OTHER SUPPLEMENTARY INFORMATION**

# Frankfort - Elberta Area Schools

2002 SCHOOL BUILDING AND SITE BOND ISSUE/CAPITAL PROJECTS FUND

2005 SCHOOL BUILDING AND SITE BOND ISSUE/CAPITAL PROJECTS FUND

## STATEMENT OF REVENUES, EXPENDITURES

### AND CHANGES IN FUND BALANCES

For the period November 7, 2002 through June 30, 2006

	2002 Issue	2005 Issue	Total
Revenue			
Investment income, net of expenses	\$ 232,193	\$ 26,402	\$ 258,595
Grants and contributions	200,000	250	200,250
Total revenue	432,193	26,652	458,845
Expenditures			
Capital outlay			
Building improvements	7,913,698	1,660,051	9,573,749
Equipment	38,925	22,028	60,953
Other	46,410	25	46,435
Bond costs and fees	52,514	32,205	84,719
Total expenditures	8,051,547	1,714,309	9,765,856
<b>REVENUES UNDER EXPENDITURES</b>	<b>(7,619,354)</b>	<b>(1,687,657)</b>	<b>(9,307,011)</b>
Other financing sources (uses)			
Proceeds from bond issue	7,514,805	1,781,959	9,296,764
Operating transfers in	104,549	8,700	113,249
Operating transfers out	-	(103,002)	(103,002)
Total other financing sources (uses)	7,619,354	1,687,657	9,307,011
<b>REVENUES OVER EXPENDITURES AND OTHER FINANCING SOURCES (USES)</b>	<b>-</b>	<b>-</b>	<b>-</b>
Fund balances, beginning of period	-	-	-
Fund balances, end of period	\$ -	\$ -	\$ -



Business and Financial Advisors  
*Our clients' success – our business*

Thomas E. Gartland, CPA  
Brad P. Niergarth, CPA  
James G. Shumate, CPA  
Robert C. Thompson, CPA  
Michael D. Shaw, CPA  
Mary F. Krantz, CPA  
Shelly K. Bedford, CPA  
Heidi M. Wendel, CPA

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL  
STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

Board of Education  
Frankfort-Elberta Area Schools

We have audited the financial statements of the *Frankfort-Elberta Area Schools* as of and for the year ended June 30, 2006 and have issued our report thereon dated August 28, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

***Internal Control Over Financial Reporting***

In planning and performing our audit, we considered the School District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Member of



415 Munson Avenue, Post Office Box 947  
Traverse City, Michigan 49685-0947  
231.946.1722, FAX: 231.946.2762  
[www.dgncpa.com](http://www.dgncpa.com)

This report is intended solely for the information and use of the Board of Education, management, Michigan Department of Education, Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Dennis, Gartland & Niergarth*

August 28, 2006

## **AUDIT-RELATED COMMUNICATIONS**

To the Board of Education  
Frankfort-Elberta Area Schools

We have audited the financial statements of ***Frankfort-Elberta Area Schools*** (the "School District") for the year ended June 30, 2006, and have issued our report thereon dated August 28, 2006. Professional standards require that we provide you with the following information related to our audit.

### ***Our Responsibility under U.S. Generally Accepted Auditing Standards***

As stated in our engagement letter dated July 5, 2005, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the School District. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. However, we offer the following comments and recommendations for your consideration.

### ***Segregation of Duties***

We remind you that an inherent weakness in your system of internal control exists because the limited size of your staff does not permit an adequate segregation of duties. Without an adequate segregation of duties, there is an increased risk that errors or fraud could occur and not be detected. We can provide consulting services to help you identify your greatest risk exposures and design procedures to reduce those risks to the extent reasonably possible.

### ***Budgeting***

During the prior year audit we recommended the School District, for management purposes, adopt a budget for the Building Trades Fund for the year ended June 30, 2006. To our knowledge this was not done during the current year under audit. We recommend this be done for the year ending June 30, 2007.



### *Building Trades Program Inventory*

As of June 30, 2006, approximately \$171,000 was held in inventory for houses constructed for resale and the Building Trades Fund owed the General Fund over \$205,000. As a result, some of the School District's cash was not available to cover other general expenditures of the School District. To relieve some of the cash flow issues for the School District, we recommend the follow:

- Partner with another entity that can provide short-term financing for construction of the homes.
- Prior to entering into an agreement to sell the home, utilize the services of an appraiser to determine a fair price for the home to assure the total cost of constructing the home and land will be recovered by the sale.

We understand management is currently reviewing costs incurred on the most recent homes constructed to determine if there are some areas where costs can be reduced on homes presently under construction and future homes.

### *Capital Assets*

As of June 30, 2006, the School District received their certificate of substantial completion for the 2005 School Building and Site Bond Issue Capital Projects Fund. Now may be a good time to perform a physical inventory of all capital assets owned and maintained by the School District. This verification of the existence of assets and completion of internal records helps establish the validity of asset records and insurance needs.

### *Credit/Purchase Card Policy*

We recommend the School District adopt a credit/purchase card policy, which at a minimum requires supporting documentation of purchases before reimbursement of the expenditure.

### *Food Service Revenues*

We noted during our test of food service revenues that actual revenues were below expected revenues. One explanation may be the School District extends credit to students for meals but does not follow up on collection of these accounts. We recommend the School District review this process and adopt a formal food service charge policy.

### *Significant Accounting Policies*

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the School District are described in Note A to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2006. We noted no transactions entered into by the School District during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

### *Agency Funds*

During the current year audit, we analyzed the student activities accounts within the agency funds. It appears the School District is accounting for some of the athletic activities through a number of student activity accounts, both the revenues and expenditures of the activities. We recommend these athletic activities be accounted and budgeted for within the Athletic Fund.

### *Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. During the audit, we evaluated management's estimates against available information as a basis for concluding about the reasonableness of these estimates. However, we do not consider such estimates to be particularly sensitive.

### *Audit Adjustments*

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the the School District's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the School District, either individually or in the aggregate, indicate matters that could have a significant effect on the School District's financial reporting process.

### *Disagreements with Management*

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

### *Consultations with Other Independent Accountants*

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

### ***Issues Discussed Prior to Retention of Independent Auditors***

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the School District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

### ***Difficulties Encountered in Performing the Audit***

We encountered no significant difficulties in dealing with management in performing our audit.

### ***Hot Topics in Education Finance***

#### ***Time and Effort Reporting Requirements***

The recently published Michigan Department of Education Accounting and Auditing alert highlights the importance of proper time and effort reporting in relation to Federal programs. We recommend that the School District and Board review these requirements and that your internal documentation requirements be reviewed for compliance with OMB Circular A-87. Proper documentation will help prevent any future potential charge-backs for Federal funds.

#### ***Budget Deficits and the Uniform Budgeting and Accounting Act***

The Michigan Department of Education has recently announced its intention to closely monitor districts that appear to be in violation of the Uniform Budgeting and Accounting Act (the "Act"). This Act requires that school districts not incur expenditures in excess of budgets or operate with a deficit budget. In the extreme case, the attorney general could take action against a school and its board members were a deficit budget to be enacted. This issue is being monitored by the Department of Education, and correspondence will be issued when violations of the Act are detected.

#### ***Hay Group Report on the Michigan Public School Health System***

A recently released report by the Hay Group gives the opinion that approximately \$280 million could be saved if Michigan were to abandon its Michigan Educational Special Services Association ("MESSA") health coverage and implement a State-wide health benefit system for public school employees. All organizations will face issues with funding health care coverage in the future and schools will be especially hard hit because school funding is not increasing at a pace to offset projected medical cost increases. MESSA has commissioned a study by Reden & Anders Ltd. to analyze the Hay report and determine if the projected savings are real. This report was recently released and points out some concerns with the methodology. There is currently legislation pending regarding this issue.

### *The 65% Solution*

The 65% solution is a school spending philosophy that has taken hold recently in a number of states. The basic premise of the philosophy is that by requiring a school to spend 65% or more of a district's budget directly in the classroom, school performance will improve and excessive overhead costs will be squeezed out. Proponents of this program cite statistics that show the top performing schools spend over 64% of their budgets directly in the classroom, while the lowest performing schools spend as little as 49% in the classroom. Opponents to the philosophy say it depends on how you measure and what is considered as classroom spending. Opponents also say it is backed mostly by voucher and charter school supporters as a tactic to help voucher legislation get passed in more states. Legislation has been passed in 2 states regarding this and 10 others have some sort of proposal in process.

### *Athletic, Student Activity, School Lunch and Other Internal Control Risks*

At this spring's MSBO conference, one of the "red-flags" raised was the lack of proper internal controls around cash intensive areas of the school district, such as athletic tickets and school lunch. As published in regional newspapers, a school district in the Northern Michigan region was recently an unfortunate victim of a \$100,000 embezzlement incident in the school lunch area. Unfortunately, a financial audit does little to provide assurance that your school district has proper procedures in place for these and other high-risk areas.

A school district needs to conduct an ongoing evaluation of its internal controls in all areas to limit its exposure. Internal controls are the policies and procedures you put in place to reduce the potential for undetected mistakes or fraud. Like most small organizations, your internal control system is inherently weakened by the absence of an adequate segregation of incompatible duties (one or a few people do everything). Everybody can make mistakes and most frauds are perpetrated by people held in a position of trust so this is an issue regardless of the qualities of the people working for you.

Internal controls are designed both to protect you from corrupt employees, customers, vendors and others and to protect honest employees from innocent mistakes and misplaced suspicions. There may be opportunities for you to reduce the risk of undetected mistakes or fraud through the implementation of a few relatively easy internal control procedures. We would be happy to work with you to identify your greatest risk exposures and offer suggestions for ways to reduce that risk with simple cost-effective procedures.

### *The Importance of Long-Term Planning*

Recent financial issues in school districts throughout the State highlight the increased need for long-term school planning. Minimal increases in the foundation allowance along with increasing health care and retirement costs will only make the future more difficult to manage. A long-term (5-year) plan is one means for a school district to proactively manage their financial future. This is a difficult exercise in today's environment, but one that is critical if the board is to analyze the impact of various scenarios on the school's future. If you have not already done so, you should consider this process. To be most effective, this should be a group process and updated on an annual basis. These projections will be useful when undergoing contract negotiations.

### *Budget Fund Balance*

State law mandates that districts do not operate with a deficit budget. State law does not, however, mandate maintaining a healthy fund balance. Maintaining a minimum fund balance is only smart management of the district's resources. A fund balance of approximately fifteen percent of the total annual operation expense of the district's General Fund budget is a good target fund balance. Setting a target fund balance to maintain would provide flexibility in dealing with unanticipated budget emergencies such as mid-year reductions in State funding. We recommend the School District discuss a target fund balance and adopt a Board policy; this will provide guidance and direction on an annual basis as each years operating budget is prepared and adopted.

### *Headlee Rollback*

Under Proposal A, districts receive a foundation allowance multiplied by the number of students. The foundation allowance is paid from two sources, property taxes and the State. The 18 mills approved by voters in 1996 for non-homestead property is the portion determined to come from property taxes. When property is sold and re-valued at a level much higher than the rate of inflation, it can cause the 18 mills to be rolled back. The State does not pick up this difference in reduction of mills. To get the full per student operational dollars that the State authorized under Proposal A, districts may find it necessary to hold an override vote to restore the full 18 mills. Headlee rollback reduces the authorized millage rate, not the levied rate. So, districts with high growth may find it necessary to hold an override vote annually if only the 18 mills are requested. Such districts might find it appropriate to request authorization of 20 to 21 mills. Since State law prohibits districts from levying more than 18 mills, there is no downside to authorizing more than the needed 18 mills. Then, if a rollback occurs, it is applied to the 20 or 21 mills, not the 18 mills levied. This would eliminate the need to come back again and again to voters to ask for the same 18 mill levy.

This information is intended solely for the use of Board of Education and management of Frankfort-Elberta Area Schools and is not intended to be and should not be used by anyone other than these specified parties.

We are pleased to serve as the School District's auditors. If there are any questions about the audited financial statements or the contents of this letter, we would welcome the opportunity to discuss them at your convenience.

*Dennis, Gartland & Niergarth*

August 28, 2006